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This bulletin is based on thirty years of research and experience by the author in the field of dairy marketing. Attention is called to four earlier reported studies by him that are directly pertinent to state regulation of consumer milk prices.

The first study was reported in 1934 in Station Bulletin 397, "Prices and Consumption of Milk in Specific Cities." The second, published by the Station in 1941 as AE-1575, "Governmental Regulation of the Sale of Milk," reported research undertaken at the request of the Illinois Legislative Council. The third study, made in 1943-44, included analysis of data collected during personal visits to the principal office of each state then under retail price control, and was published in the author's book *The Milk Industry* (Ronald Press, 1945). A fourth study was reported in University of Illinois Agricultural Economics Bulletin 7, in the article "Potential Expansion of Sales of Fluid Milk as Related to Demand Elasticities."

Between 1936 and 1963 the author also presented evidence as an expert witness at hearings on state retail milk price control as follows: Pennsylvania (Philadelphia), 1936; Indiana (Indianapolis), 1940; Pennsylvania (Allentown), 1942; Oregon (Portland), 1947; British Columbia (Vancouver), 1951, 1953, and 1954; California (Hanford), 1953; Pennsylvania (Pittsburgh), 1955; Rhode Island (Providence), 1961; Pennsylvania (Pittsburgh), 1962; Quebec (Montreal), 1962; and Florida (Jacksonville), 1963.

## CONTENTS

History of State Regulation of Retail Milk Prices . . . . .	2
Effectiveness of State Control of Consumer Prices . . . . .	4
Distributors' Gross Margins a Measure of Efficiency . . . . .	5
Costs and the Distributors' Margin . . . . .	7
Current Situation in 151 Markets . . . . .	10
Economics of State Control, 1933-1962 . . . . .	11
DGM's Higher in Controlled Markets . . . . .	12
DGM's in Nine Continuously Controlled Markets . . . . .	12
DGM's Drop in Decontrolled Markets . . . . .	14
Uncontrolled Markets Classified Into Three Groups . . . . .	18
Retail Price Control Tends to Curb Milk Consumption . . . . .	19
High Retail Price as Related to Milk Consumption in Philadelphia and Pittsburgh . . . . .	21
High Prices Encourage Use of Whole Milk Substitutes . . . . .	21
High Distribution Margins Encourage Law-Breaking . . . . .	22
Retail Pricing Not Needed to Protect Producer Prices . . . . .	24
States Cannot Control Producer Prices for Out-of-State Milk . . . . .	24
Retail Price Control Prevents Use of Loss Leaders . . . . .	25
Conclusions . . . . .	26
Appendix A . . . . .	28
Appendix B . . . . .	29



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# IS STATE CONTROL OF CONSUMER MILK PRICES IN THE PUBLIC INTEREST?

ROLAND W. BARTLETT<sup>1</sup>

MILK PRICE-CONTROL LEGISLATION came into being primarily as a result of disastrously low farm prices in the early 1930s. Dairy farmers were hard hit by the depression. With a perishable product they had little or no protection in the marketplace. Collective bargaining between producers and distributors led to violence, dumping of milk, and general disruption of the dairy industry. Distributors faced bankruptcy in many markets. In this situation it was evident that something had to be done to raise the income of milk producers and restore some measure of stability to the milk markets.

In an attempt to bring order out of chaos, federal and state governments both took action in 1933. On May 12, 1933, Congress passed the Agricultural Adjustment Act, under which the Secretary of Agriculture was authorized to license and enter into marketing agreements with producers and distributors handling products entering interstate or foreign commerce. This tri-party arrangement provided for quotas and market pools, producer prices for different classes of milk, and minimum wholesale, store, and home-delivered prices.

In December 1933, only seven months after passage of the act, the federal government discontinued regulation of retail prices. Reasons given for this action were (1) rampant violation of the provision dealing with retail prices and inability to enforce it, particularly in markets that did not overlap state boundaries; (2) under-the-counter deals between producers and distributors; and (3) granting of unnecessarily wide distribution margins that encouraged chiseling and secret rebates and discounts.

With elimination of retail price fixing, the federal government then turned its attention to federal orders, which established minimum class prices for milk sold to distributors. Unlike marketing agreements and licenses, which required a favorable vote of at least two-thirds of the producers and half the distributors in the market, federal orders could be established by a favorable vote of producers. Although subject to many trials and tribulations, particularly during their early period of

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operation, federal orders have become rules of the game for regulation of producer pricing in some 82 marketing areas.

## History of State Regulation of Retail Milk Prices

At the same time that federal regulation was being passed, statutes to effect the same objectives were being enacted in several states. In April 1933, New York passed the first state law to establish minimum producer, wholesale, and retail milk prices, and before the end of the depression of the 1930s, 25 additional states took similar action (Table 1). Most of these laws created a state milk commission or control board that was to hold public hearings and determine fair minimum prices. Usually several months passed before the commission was organized and could issue its first pricing orders.

Most states regarded milk price fixing as temporary, and at least ten wrote into their original bills clauses that fixed a date beyond which the law could not be extended without legislative review and renewal. Five of the states eventually revised their laws to provide for permanent milk price control. But Indiana, Ohio, South Dakota, and Wisconsin all allowed their control statutes to lapse before July 1943. New York essentially replaced its original law with one that did not include a provision for fixing prices at retail level.

In Connecticut, retail pricing was suspended by the control board in 1935, but the statute stayed on the books until 1941.

Passage of a milk control bill did not always mean that it was accepted even temporarily. In Maryland, Michigan, Utah, Texas, and Washington, state supreme courts declared the law unconstitutional less than 18 months after it was approved by the legislature. In Maryland and Utah, at least, retail prices were never controlled.

By mid-1943, 11 of the 26 states had revoked their authority to control retail milk prices. At that time prices for nearly all commodities were frozen by wartime authority of the federal government, and there was no further state legislative activity in this area until after World War II.

In 1947, milk price control at the retail level was suspended in Massachusetts, but the commission's authority to reinstate it was retained. Since then several states have made similar moves. In 1954, however, a statewide public referendum forced repeal of the milk control law in Oregon. In 1959, retail price fixing for milk was put into effect in Nevada, approved in North Carolina, and declared unwarranted in Massachusetts. In 1962 it was approved by the Louisiana legislature and repealed by the Rhode Island legislature.



Table 1.—Duration of State Control of Retail Price of Fluid Milk, 1933-1963

State	Control established <sup>a</sup>	Control discontinued <sup>b</sup>
Alabama.....	1935	in force
California.....	1937	in force
Connecticut.....	1933	(1935) <sup>e</sup>
Florida.....	1933	(1957)
	1963 <sup>d</sup>	in force <sup>o</sup>
Georgia.....	1937	in force
Indiana.....	1935	1940
Louisiana.....	(1963) <sup>f</sup>	in force
Maine.....	1935	in force
Maryland.....	1935	1935
Massachusetts.....	1934	(1947)
	1958	(1959)
Michigan.....	1939	1940
Mississippi.....	1960	in force
Montana.....	1935	in force
Nevada.....	(1959) <sup>*</sup>	in force
New Hampshire.....	1935	in force
New Jersey.....	1933	(1949)
	1953	(1955)
	1962	in force
New York.....	1933	1937
North Carolina.....	1959	never used <sup>h</sup>
Ohio.....	1933	1935
Oregon.....	1933	1954
Pennsylvania.....	1934	in force
Rhode Island.....	1934	(1961) <sup>i</sup>
South Dakota.....	1935	1937
Texas.....	1934	1935
Utah.....	1937	1937
Vermont.....	1933	in force
Virginia.....	1934 <sup>j</sup>	in force
Washington.....	1934	1935
Wisconsin.....	1935	1941

<sup>a</sup> Year of first pricing orders is given (in parentheses) if different from year legislature passed enabling statute.

<sup>b</sup> Parentheses indicate control suspended rather than permanently invalidated.

<sup>c</sup> Law repealed in 1941. <sup>d</sup> Miami not included after February 1956.

<sup>e</sup> Control again suspended in April 1964. <sup>f</sup> Law passed in 1962.

<sup>g</sup> The milk commission created in 1955 was largely a study group until 1957, when it requested and received authority to fix milk prices at all levels.

<sup>h</sup> State uses law prohibiting sales below cost, but has not yet invoked retail price fixing.

<sup>i</sup> Law repealed in 1962. <sup>j</sup> Arlington-Alexandria not included after August 1959.

<sup>k</sup> Arlington-Alexandria not included after August 1959.

Sources: Ala., Calif.—Barriers to Increased Consumption of Fluid Milk: A Special Report by the National Grange (Washington, D.C.: The National Grange, 1955), p. 81. Conn.—Cornell Agr. Exp. Sta. Bul. 908, pp. 8, 85-86, 1954. Fla.—Letter from E. V. Fisher, Administrator, Fla. Milk Commis., July 18, 1963; and Dairy Record, Oct. 2, 1963, p. 5. Ga.—Same as Ala. Ind.—Burn's Ind. Stat. Ann., c. 281, p. 1365 (1935), and c. 198 § 6, p. 616 (1941). La.—La. Stat. Ann., p. 339 (1962); and La. Milk Commis. Docket LMC-63-P1. Me., Md., Mass.—Same as Conn. For Mass. also see Univ. Ill. Agr. Econ. Bul. 3, pp. 64-65, 1961; and Univ. Ill. Agr. Econ. Bul. 5, pp. 26-27, 1962.

Mich.—Same as Mass. (first ref.). Miss.—Wholesale and retail pricing orders, Miss. Milk Commis., Nov. 1961. Mont.—Same as Ala. Nev.—Letter from C. J. Cassady, Sec.-Administrator, Nev. Dairy Commis., July 24, 1963; and (First) Biennial Rept. of the Dairy Commis. (State of Nevada) p. 7, Dec. 1958. N.H., N.J.—Same as Conn. For N.J. also see Vt. Agr. Exp. Sta. Bul. 565, p. 57, 1951; and Cornell Agr. Exp. Sta. Bul. 918, p. 79, 1955; and letter from Floyd R. Hoffman, Director, N.J. Dept. Agr., May 4, 1964. N.Y.—Letter from L. Spencer, Prof. of Mktg., Cornell Univ., July 17, 1963. N. Car.—Letter from H. A. Homme, Dairy Mktg. Specialist, N. Car. St. Col., Oct. 22, 1963. Ohio—Same as Mass. (first ref.).

Ore.—Letter from E. N. Searls, Mktg. Specialist, Wash. St. Univ., July 25, 1963. Penn., R.I.—Same as Conn. S.D.—Letter from R. L. Beck, Asst. Prof. of Econ., S. Dak. St. Col., July 26, 1963. Tex.—Gen. and Special Laws of Texas, c. 19, p. 56 (1934); and Schechter Poultry Corp. v. U.S., 295 U.S. 495 (1935). Utah—Same as Mass. (first ref.); and letter from G. T. Nelson, Econ. Dept., Brigham Young Univ., August 14, 1963. Vt., Va.—Same as Conn. Wash., Wisc.—Same as Mass. (first ref.).

As of January 1, 1964, of the 29 states that have passed laws to control retail milk prices, 14 were using their laws;<sup>1</sup> 13 had repealed their laws; the Massachusetts law was in a state of suspension (court ordered); and in North Carolina, authority to use such control had not yet been invoked.

## Effectiveness of State Control of Consumer Prices

The marketing of milk is perennially beset with problems even though many of the current ones are not the same as those extant when state retail milk price controls were initiated. As one method of attack on current problems, every biennium one or more groups in each of some 30 states introduce bills in their state legislatures either to initiate or to abolish markup laws, fair-trade procedures, or retail price controls; the bills seeking to revoke controls of consumer prices seem to be somewhat more common.

Currently (1964), there is agitation in several states in the Midwest, including Minnesota, Ohio, and Wisconsin, to enact legislation to control consumer prices for milk. In contrast, in several states, including Maine, New Hampshire, and Pennsylvania, vigorous attempts are taking place to eliminate state control of consumer prices. Evidence to this effect is found in a report that the signatures of some 80,000 housewives have been obtained in protest of consumer price-fixing in Pennsylvania.<sup>2</sup>

Much of the pro and con discussion of the need for passing new laws or abolishing old ones has been based on scattered evidence that may or may not be valid for long-run public policy. Some questions that logically concern state regulation of consumer prices are: Has it encouraged innovation and efficiency in milk distribution, or has it tended to perpetuate inefficiency? Has it enhanced or been a barrier to increased per capita milk sales? Has this control prevented price wars and stabilized milk markets, or has it caused perpetual unrest and disregard for the law?

Since retail milk prices have been controlled in some states for three decades, during which period most states have had no controls, a body of statistical evidence as well as experience has been accumulated that can serve to either validate or invalidate the usefulness of this type of regulation. In analyzing this problem one might ask what constitutes a good yardstick for measuring distribution efficiency under state retail price control.

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<sup>1</sup> In April 1964, wholesale and retail price control in Florida was eliminated by the state milk commission.

<sup>2</sup> *Dairy Record*, May 20, 1964, p. 6.

## Distributors' Gross Margins a Measure of Efficiency

Three potential measures of distribution efficiency as between different markets are: (1) A comparison of unit costs of each of the principal distributors in a given market or group of markets with those of the principal distributors in other markets; (2) a comparison of the retail prices of milk in a given market or group of markets with those in other markets; or (3) a comparison of the distributor gross margins in a given market or group of markets with those in other markets.

Ideally one would obtain the unit costs for each of the principal distributors in each market for measuring efficiency for each of the different markets. Unfortunately, not only are such costs not available, but, if available, the expense for getting these costs for a large number of distributors would be prohibitive. This would be particularly true if the study covered a long period of time. Hence while scattered samples of computed unit costs can be used to check other measures of efficiency, the use of unit costs to measure efficiency of a large number of markets is not practical.

A second potential measure of efficiency is a comparison of the retail prices of milk in different markets. From the viewpoint of a consumer, a low retail price would seem to indicate an efficient market while a high retail price would seem to indicate an inefficient market. A closer scrutiny, however, shows the unreliability of retail price as a measure of efficiency. The retail store price of milk in any market is the sum of the Class I price plus the distributors' gross margin. Because of differences in transportation costs, the Class I price tends to increase as the distance from the low-cost surplus-producing areas of the Midwest to any given market increases. Thus it may cost \$1.50 or more per 100 pounds to transport milk from Chicago or Minneapolis-St. Paul to markets in the northeast or south. Because of this range in transportation costs between different markets, neither the retail price nor the Class I price constitutes a reliable measure of efficiency.

Since neither unit costs nor retail prices constitute a practical measure of market efficiency, is there any reliable measure that can be used to show differences and changes in efficiency between different markets?

On the basis of available data and cross-checks for reliability of these data, the distributors' gross handling margin appears to be the best measure for measuring distribution efficiency for a large number of markets. Theoretically, the distributors' gross margin (DGM)

would be approximately the same in all markets if they all operated at the same level of efficiency.<sup>1</sup> This margin, which is available for many markets over a long period of time, covers the distributors' costs of receiving, processing, packaging, storing, and transportation, profit, and the retail store mark-up. In this study the DGM in each of the 47 markets used was obtained by subtracting the Class I price from the lowest reported store price.<sup>2</sup> These prices were obtained from the USDA Fluid Milk and Cream Reports or from information received from market administrators or from trade associations. Class I prices and retail store prices thus obtained were checked with local sources for each of the 14 state-controlled markets<sup>3</sup> and were found to deviate only a fraction of 1 percent from those of the original sources.

In reviewing the reliability of the distributors' gross margin as a measure of competitive performance, one should realize that this is not an indicator of average distribution margins nor of profitability. A review of costs and profits of a large number of milk distributors in different markets indicates a close relationship between the DGM's used and unit costs including profit whether in low-margin or in high-margin markets.<sup>4</sup>

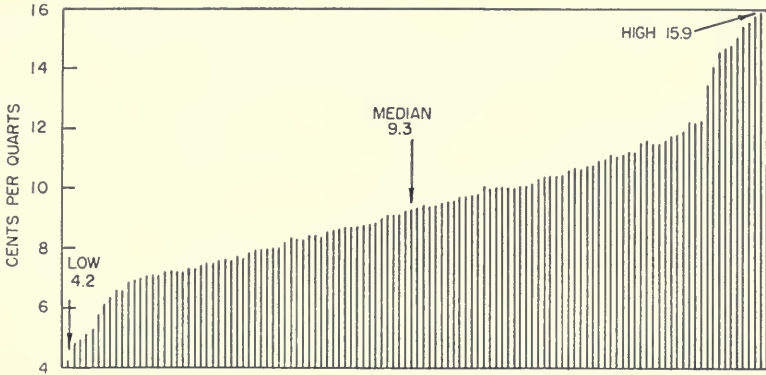
<sup>1</sup> It is true that there are differences in wage rates between different markets. Distributors' gross margins, however, range from less than 5 cents a quart in some markets to more than 15 cents in others, and only a minor part of this difference, probably not more than 1 or 2 cents a quart, is due to differences in wage rates.

<sup>2</sup> While it would have been desirable to use the average price at which milk was sold in each market, this price is not available for most markets. Spencer and Parker (N.Y. (Cornell) Agr. Exp. Sta. Bul. 965, p. 38, July 1961) have reported that test calculations indicated that the use of store prices for the New York City market, 1950-1959, would not have given results significantly different from those based on the average price. For the detailed method used in computing the distributor gross margin for each market, see Appendix A.

<sup>3</sup> The 1962 data as originally shown and the Class I price for these 14 markets have been verified by the following authorities in correspondence dated as shown. Continuously controlled markets: Atlanta, Ga.—John H. Dillard, Admin. Asst., Ga. Milk Commis., Atlanta; April 8, 1964. Birmingham and Mobile—Lowell E. Wilson, Assoc. Prof. of Agr. Econ., Auburn Univ., Auburn, Ala.; Dec. 4, 1963. Los Angeles, San Diego, San Francisco—J. H. McEwen, Milk Economist, Bur. Milk Stabil., Sacramento, Calif.; Nov. 19, 1963. Philadelphia, Pittsburgh—Maurice M. Martin, Admin. Officer, Milk Control Commis., Harrisburg, Pa.; Jan. 7, 1964. Richmond—M. C. Conner, Prof. of Agr. Econ., Va. Polytech. Inst., Blackburg, Va.; April 2, 1964. Decontrolled markets: Boston—Richard D. Aplin, Mkt. Administrator, April 6, 1964. Jacksonville, Miami—F. B. Leverett, Acting Administrator, Fla. Milk Commis.; Nov. 26, 1963. Portland, Ore.—Elmer N. Searls, Ext. Dairy and Poultry Mktg. Spec., Wash. St. Univ., Puyallup, Wash.; Dec. 2, 1963. Providence—Robert W. Cherry, Mkt. Administrator, Providence, R.I.; Nov. 19, 1963.

<sup>4</sup> Over the years, as an expert witness, the writer has had the privilege to review the itemized costs and profits of many firms for which public information has not been available. This information along with published cost studies and computed DGM's furnished the basis for this statement.





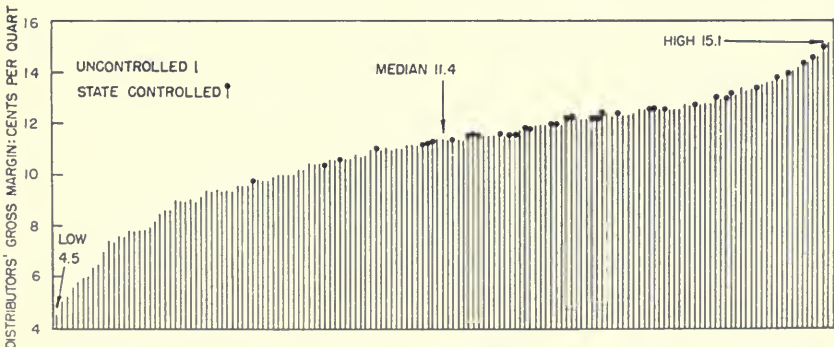
Cost of receiving, processing, bottling, administration, selling, and delivery of milk to stores for specific dealers. Data from *The Milk Industry* (see Table 2), adjusted to 1962 price levels. (Fig. 1)

It should be noted here that one of the few cost studies available shows that the range of variation for costs (Fig. 1) is about the same as the range for DGM's (Fig. 2). This fact lends weight to the assertion that the DGM is a reasonably good approximation to actual costs.

## Costs and the Distributors' Margin

Some distributors, particularly those with high costs, have questioned the reality of low-cost operations such as those shown for some markets. Where can the distributor accused of being inefficient cut costs, and can he make a profit if he does?

There are very few detailed cost studies, but even some of the more



Distributors' gross margins for milk sold through stores in 37 state-controlled and 114 uncontrolled markets, 1962. (Fig. 2)

**Table 2 — Plant Costs, Administrative and General Costs, and Selling and Delivery Costs to Stores, 23 Low-Cost Plants and 23 High-Cost Plants, 1962<sup>1</sup>**

	23 low-cost plants	23 high-cost plants
	<i>cents per quart</i>	
Plant costs.....	3.18	6.64
Administrative and general costs.....	.44	1.28
Selling and delivery costs.....	2.76	5.21
Total.....	6.38	13.13

<sup>1</sup> *The Milk Industry* (Bartlett), Ronald Press, 1945. Table 1, p. 267. Adjusted for changes in the general price level.

**Table 3. — Changes in Labor Efficiency, Seven Milk Plants**

Plant	Stores served		Gallons handled per day, 7-day week		Gallons per man-hour	
	Sept. 1950	Sept. 1959	1950	1959	1950	1959
1.....	35	51	700	5,100	20	57
2.....	43	100	2,000	13,600	43	108
3.....	100	116	4,700	15,000	54	113
4.....	51	131	3,600	15,400	55	116
5.....	162	185	16,000	26,700	72	99
6.....	142	217	7,700	27,500	52	100
7.....	300	235	18,500	32,600	67	136
Average.....	119	148	7,600	18,000	52	105

Source: Univ. Ill. Agr. Econ. Bul. 3, Table 1, p. 10, June 1961.

general studies demonstrate that inefficiency frequently exists in the areas of plant operation, plant-to-store transportation, and labor costs.

Itemized costs of 23 low-cost and 23 high-cost plants taken from a study of 117 plants showed that the average unit costs of the high-cost plants were over double the average of the low-cost plants (see Table 2). Unit costs for the low-cost group were less than for the high-cost group in each of the three classifications.

Other studies show that progressive dairy firms have made much progress in lowering unit costs of labor for plant operation (Table 3). Over a period of nine years, seven plants improved their efficiency to the point of doubling the average number of gallons handled per man hour while increasing the average plant volume by nearly 140 percent.

Reasons for lower unit labor costs were summarized by Ray B. Bush, manager of the milk division of Safeway stores:<sup>1</sup>

<sup>1</sup> Ray B. Bush, "Keeping up to date in the processing and distribution of milk." Univ. Ill. Agr. Econ. Bul. 3, pp. 6-14, June 1961.



Streamlined production, bulk handling, permanent pipelines, C.I.P. cleaning, and good plant management all make for low labor costs, which are best measured and compared by the gallons of product handled per man-hour . . . . We include everyone on the payroll except the fieldman and drivers (our drivers are on Safeway payroll) — all supervisors, even the manager, are included. Gallons are based on gallons of product sold.

A more recent analysis of processing costs in four model plants of different sizes demonstrates the economies of scale for both labor and capital. Assuming efficient plant operation, of seven fluid milk items packaged in 17 different containers (both paper and glass), Webster *et al.*<sup>1</sup> estimate costs as follows:

<i>Capacity of plant</i>	<i>Investment per quart of daily capacity</i>	<i>Total costs per quart</i>
6,000 quarts daily.....	\$24.93	5.7¢
20,000 quarts daily.....	10.87	3.9¢
50,000 quarts daily.....	8.27	3.2¢
100,000 quarts daily.....	7.00	2.9¢

Had the operations included 100 percent paper or 100 percent glass and a smaller number of items handled, unit costs would have been substantially lower.

Some distributors have maintained that it is impossible to operate a milk business at a profit at the low distribution margins found in some markets. A long-time review of distribution margins of several specific markets and comparison of these margins with unit costs indicate that profitable operations are possible even with low margins. A review of 20 low-margin markets from our 90-market study showed (Table 4):

1. In 1962, the DGM of the 20 low-margin markets ranged from 5.07 to 9.05 cents and averaged 7.56 cents a quart. The 1962 unit costs (adjusted) of 58 dealers below the median ranged from 4.2 to 9.2 cents and averaged 7.52 cents (Fig. 1). It is reasonable to believe that efficient dealers in each of the markets could operate at a profit.

2. Twelve of the 20 low-margin markets had DGM's from 1949 to 1962 which were less than 9.0 cents a quart and averaged 7.8 cents a quart. It is unreasonable to believe that the majority of milk distributors in any market could operate at a loss for a 14-year period.

3. Seventeen of the 20 markets had strong labor unions which negotiated wage rates with distributors. The wage rate is not a limiting factor for low-cost milk distribution. Even with high wage rates, it is

<sup>1</sup> F. C. Webster, Alec Bradfield, J. R. Bowring, K. A. Taylor, and H. C. Moore, *Economics of Size in Fluid Milk Processing Plants*, Vt. Agr. Exp. Sta. Bul. 636, pp. 4-8, June 1963.

Table 4. — Distributors' Gross Margins for 20 Low-Margin Markets, 1949-1962<sup>1</sup> and 1962 (cents per quart)

Market	1949-1962	1962	Market	1949-1962	1962
1.....	9.03	5.07	12.....	8.33	7.77
2.....	7.51	5.78	13.....	8.21	7.81
3.....	8.97	5.96	14.....	7.71	8.06
4.....	7.75	6.13	15.....	9.76	8.11
5.....	10.97	6.93	16.....	9.84	8.42
6.....	7.03	7.48	17.....	7.42	8.59
7.....	7.93	7.48	18.....	9.30	8.87
8.....	7.83	7.53	19.....	7.27	9.01
9.....	8.72	7.71	20.....	10.94	9.05
10.....	9.03	7.72	20-market average..	8.66	7.56
11.....	9.70	7.77			

<sup>1</sup> Our study of distribution margins for 90 markets for 1949 to 1959 was reported in University of Illinois Agricultural Economics Bulletin Number 5, pages 48 to 50. This earlier study was brought up to 1962, and the 20 low-margin markets reported here were taken from the 90-market study.

possible to keep low the unit costs of a milk business if labor is used efficiently.

4. Milk distribution in the 20 markets was associated with low costs attained through mass distribution through supermarkets or through "captive" neighborhood stores. Each of the 20 markets had supermarkets, while 10 of the 20 low-margin markets in 1962 distributed milk through "captive" neighborhood stores, owned by a firm which also owned a milk plant.

### Current Situation in 151 Markets

An array of the DGM's of 151 markets for which 1962 data were available (Fig. 2) shows the relative positions of 37 markets in which retail milk prices were under state control and of 114 markets not under state control.

The average DGM for controlled markets was 12.2 cents a quart, compared with 10.5 cents a quart for uncontrolled markets. The lowest DGM among the controlled markets was 9.8 cents, more than twice the lowest margin in the uncontrolled markets. Roughly one-fifth of the controlled markets had DGM's below the median, while for the uncontrolled markets the figure was three-fifths.

It appears, then, that efficiency as measured by the DGM is less likely to be found in markets where minimum retail milk prices are fixed by the state. The fact that a market is not under state control, however, does not necessarily mean that its distributors operate with above-average efficiency.

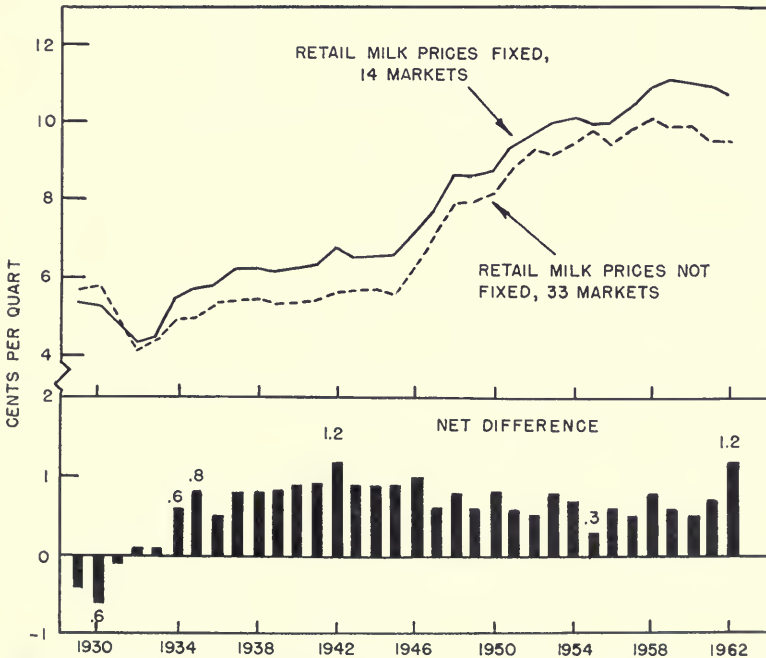
For more thorough evaluation of the situation as it is today, however, it is necessary to examine the evolution of state control.

### Economics of State Control, 1933-1962

Continuous data for the years 1929-1962 were available for 47 markets with populations of 200,000 or over. Fourteen of the markets were considered to be under state retail price control, while 33 markets were classified as uncontrolled.

Of the 14 controlled markets, nine — Atlanta, Birmingham, Los Angeles, Mobile, Philadelphia, Pittsburgh, Richmond, San Diego, and San Francisco — were under state control continuously from the 1930s up through 1962 (Table 1). The five remaining markets — Boston, Jacksonville, Miami, Providence, and Portland, Oregon — were under state control for at least 14 years, but were decontrolled as their respective states revoked or suspended retail price regulation.

The 33 markets classified as uncontrolled either never were under state regulation of retail milk prices (17 markets), or were regulated for 6 years or less (16 markets).



DGM's for milk sold through stores in 14 state-controlled and 33 uncontrolled markets, and net differences, 1929-1962. (Fig. 3)

## DGM's Higher in Controlled Markets

The DGM's of controlled markets have exceeded those of uncontrolled markets during the entire period of state regulation (Fig. 3). For the 29-year period 1934 to 1962, the DGM's of the 14 controlled markets averaged 8.35 cents, or 0.8 cent a quart above the average of the 33 uncontrolled markets (7.54 cents).

Three rather definite trends were shown for the period as a whole. (1) From 1934 to 1942, the DGM difference between controlled and uncontrolled markets tended to become wider, going from 0.58 cent a quart in 1934 to a high of 1.15 cents a quart in 1942. (2) From this high, the difference tended to diminish until it reached a low of 0.35 cent a quart in 1955. (3) Since 1955 the DGM's of state-controlled markets have increased much more rapidly than those of uncontrolled markets. By 1962, the DGM of the 14 markets designated as state controlled had increased to 10.8 cents a quart, or 1.2 cents above that of the 33 uncontrolled markets. This difference was 50 percent above the 29-year average, 0.8 cent.

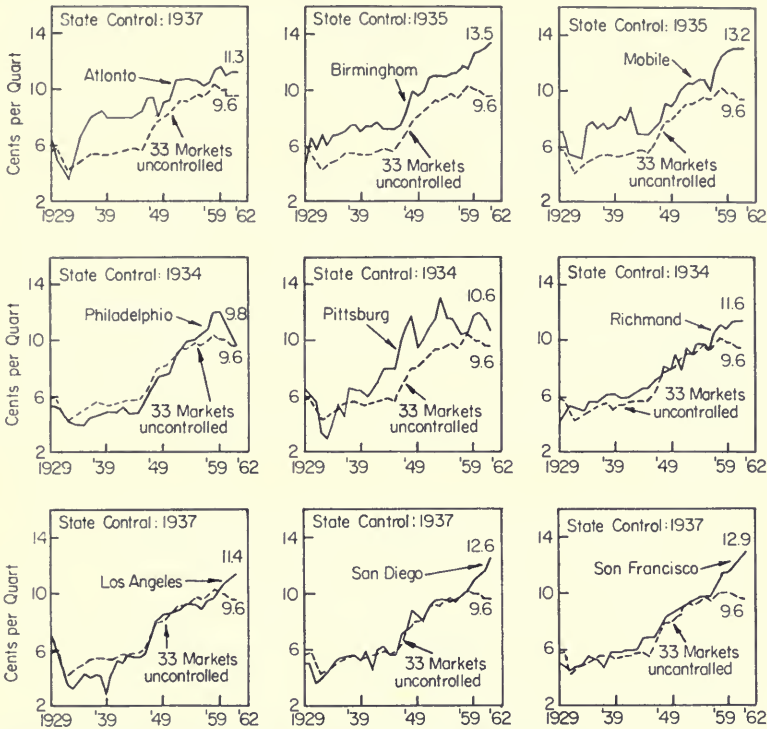
## DGM's in Nine Continuously Controlled Markets

Of the 14 markets classified as state controlled, nine were under continuous control from some time in the 1930s to 1962 while, as stated, five were decontrolled before the end of this period.

From 1934 to 1962, the distributors' gross margin for the nine specific markets averaged 8.5 cents a quart, or 1.0 cent above the average of the 33 markets (7.5 cents). Each year during this period the DGM of the controlled markets was higher than that of the uncontrolled markets.

Changes in the DGM's of each of the nine controlled markets and the 33 uncontrolled markets from 1929 to 1962 are shown in Figure 4. The most important fact shown in these comparisons is the relative increase in DGM's of the controlled markets in recent years during a period when those in the uncontrolled markets were declining. In 1962, DGM's in six of the nine markets were at an all-time high, while in one — Atlanta — the 1962 DGM was only slightly below that of 1959.

In only two of the nine controlled markets, Philadelphia and Pittsburgh, have DGM's been reduced in recent years. In Pittsburgh, the DGM was reduced from a high of 13.1 cents a quart in 1953 to 10.3 cents in 1957. After long costly hearings, quantity discounts were made available in Pittsburgh for milk sold in half-gallon containers. Later, also after long hearings, quantity discounts were made available



DGM's for milk sold through stores in markets where retail price control continued from the 1930's through 1962. (Fig. 4)

on gallon containers in both Philadelphia and Pittsburgh. It is a significant fact that quantity discounts in these controlled markets came into being long after they had been brought into regular use in most of the larger uncontrolled markets.

In 1962, not one of the nine controlled markets permitted captive neighborhood stores, which had come into Boston and Providence following decontrol. In 1962, the average DGM of the nine markets (11.9 cents) was 6.1 cents a quart above the average DGM in Boston and Providence (5.8 cents) and 1.1 cents above the average DGM of Jacksonville and Miami (10.8 cents).

In looking for a more favorable story of state retail price control, one finds that over the years, California has done a better job than any other state in establishing retail and wholesale prices on an objective basis<sup>1</sup> and in keeping distribution margins at a reasonable level.

<sup>1</sup>This includes some excellent studies on unit costs of distribution that have been made and published by the University of California.



From 1937 to 1957, the DGM's of Los Angeles, San Diego, and San Francisco deviated only slightly from the average of the 33 uncontrolled markets (Fig. 4). California administrators did not permit in their markets the high DGM's shown for many of the other state-controlled markets during this period.

In recent years, however, the situation has changed. Since 1957, the DGM's in Los Angeles, San Diego, and San Francisco, have increased sharply, and in 1962 were among the highest of the nine markets under continuous state control. These high margins and high retail prices have resulted in partial disintegration of retail milk price control in California. This is evidenced by two things. First, the advent of a large number of "drive-ins" which sell milk at prices below the minimum established at stores.<sup>1</sup> And second, an ever-growing movement at each biennial legislature in California to decontrol retail price fixing.

### DGM's Drop in Decontrolled Markets

Between 1947 and 1962, five of the 14 markets that had been under state retail price regulation, including Boston, Jacksonville, Miami, Providence, and Portland, Oregon, were decontrolled. In this situation one may logically raise such questions as: What have been the results of decontrol? Did the DGM's and retail milk prices in these markets increase or decrease after decontrol? What effect, if any, did decontrol have upon per capita consumption of milk?

Decontrol of the five markets was followed by a sharp reduction in the DGM of these markets (Fig. 5). In contrast, during this same period the DGM of the nine remaining controlled markets increased sharply. Thus by 1962 the DGM of the nine controlled markets averaged 11.9 cents a quart, or 3.1 cents above the average DGM of the five decontrolled markets (8.8 cents). Only 12 years earlier, in 1950, the DGM of these two groups had been the same (8.9 cents).

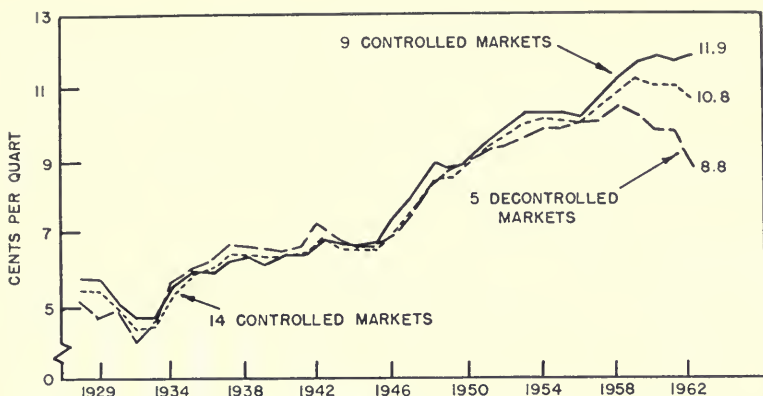
Decontrol permitted enterprising firms in the five markets to introduce innovations and new techniques that made possible sharp reductions in gross distribution margins and retail prices to consumers. A review of changes in the DGM for each of the decontrolled markets as compared with those of the 33 uncontrolled markets is shown below.

**Boston.** Decontrol in Boston was associated with the following:

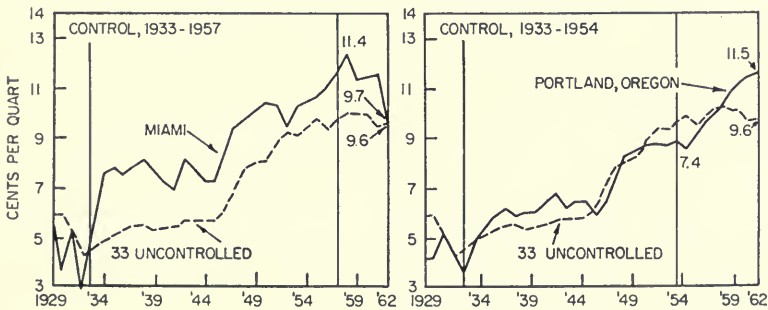
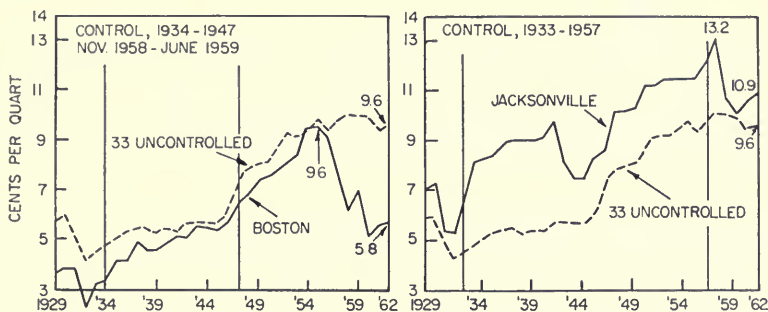
1. Boston's DGM was all but cut in half between 1955 and 1960, going from 9.6 cents a quart to 5.0 cents (Fig. 6). Since the Class I

<sup>1</sup> Drive-In Dairies in Central California, U.S. Dept. Agr., Marketing Research Report No. 636, December 1963, 11 pp.

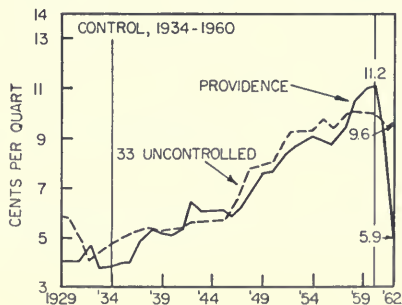


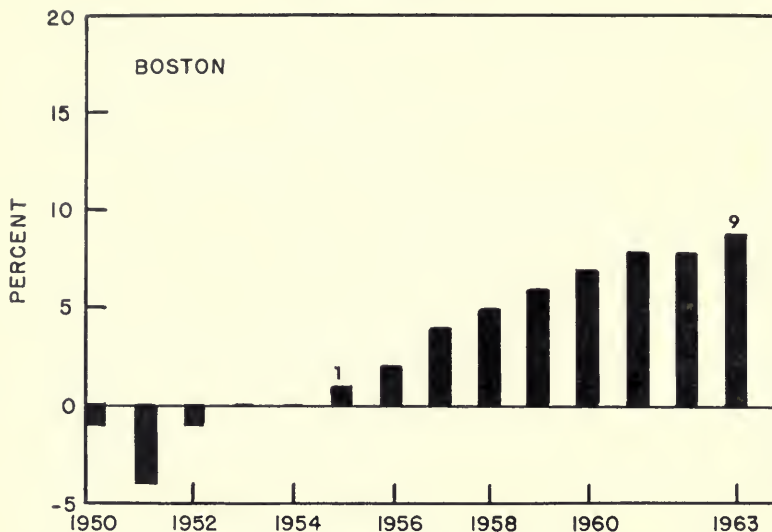


DGM's for milk sold through stores in 9 controlled and 5 decontrolled markets, 1929-1962. (Fig. 5)



DGM's for milk sold through stores in 33 uncontrolled markets and specific regulated markets that discontinued retail price regulations. (Fig. 6)





Amount by which per capita Class I sales in Boston differed from those for the United States, 1950-1963. (Source: USDA.) (Fig. 7)

price in Boston was established by federal order and was not affected by decontrol, lower DGM's resulted in lower retail prices.

2. The sharp decrease in DGM in Boston was associated with the entrance into the market in 1955 of the Cumberland Farms Dairy with its "captive" neighborhood dairy stores. By 1959, this firm had 39 stores; by January 1962, 146; and by October 1963, 260.<sup>1</sup>

3. Lower DGM's and lower retail prices in Boston were associated with a substantial increase in per capita consumption of milk as compared with that for the United States as a whole (Fig. 7). From 1951 to 1954, per capita milk sales in Boston averaged 1.2 percent below those for the United States. By 1960 Boston's milk sales had increased to 7 percent above the U.S. level, and to 9 percent in 1963.

4. City-wide newspaper publicity and consumer "patronage refunds" played an important part in effecting a relative increase in milk sales in Boston. In June 1959, the court ruled that Massachusetts state control of consumer milk prices, which had been reintroduced in November 1958, was illegal. Coupons valued at \$100,000 given by Cumberland Farms during the seven months of retail control were redeemed in full in the fall of 1959. Day-to-day newspaper publicity of retail prices

<sup>1</sup> For a discussion of the operation of these stores, see Univ. Ill. Agr. Econ. Bul. 5, pp. 26-27, Nov. 1962. For discussion of a similar operation in Canada, see Univ. Ill. Agr. Econ. Bul. 7, pp. 10-14, Sept. 1963.

before, during, and after price control and redemption of coupons brought these prices vividly to the attention of consumers.

Two conclusions may be drawn from the Boston case:

First, the introduction of new low-cost methods of milk distribution, which resulted in lower distribution margins and lower prices to consumers, came about when retail prices in this market were not under regulation. It is doubtful if Boston consumers would now be enjoying the benefit of very low distribution margins and retail prices if state retail price control had continued. In May 1964, the distributors' gross margin in Boston was 6.4 cents a quart.

Second, maintaining Class I sales in Boston at a level above that for the United States as a whole, has brought milk consumption in Boston more nearly in line with that recommended by nutritionists, although still below their recommendations.

**Providence.** The effect of suspension of control in 1961 and later of complete decontrol in Rhode Island in 1962 was drastic. From a minimum of \$1.02 a gallon in July 1961, the price to consumers in Providence dropped to 77 cents after decontrol, a net decrease of 25 cents a gallon or 6¼ cents a quart. The entire reduction in retail price was absorbed in a lower distribution margin, which was reduced from 49 cents a gallon under state control to 24 cents with no control. In 1962 the DGM in Providence averaged 5.9 cents a quart, or 5.3 cents less than its average in 1960 (11.2 cents). Reductions in retail milk prices have occurred so recently in Providence that it is not possible to measure changes in milk consumption resulting from these lower prices.

**Jacksonville and Miami.** Decontrol of Jacksonville and Miami brought reductions in distribution margins and retail prices similar to those for Boston and Providence. The introduction of low-cost distribution methods in these Florida markets took place only after they had been decontrolled. And as in Boston and Providence, it is doubtful that consumers in Jacksonville and Miami would have enjoyed the sharp reductions in distribution margins and retail prices had control of retail prices been continued under state regulation. Reductions in retail milk prices in these two markets also have occurred so recently that it is not possible to measure resulting changes in milk consumption.

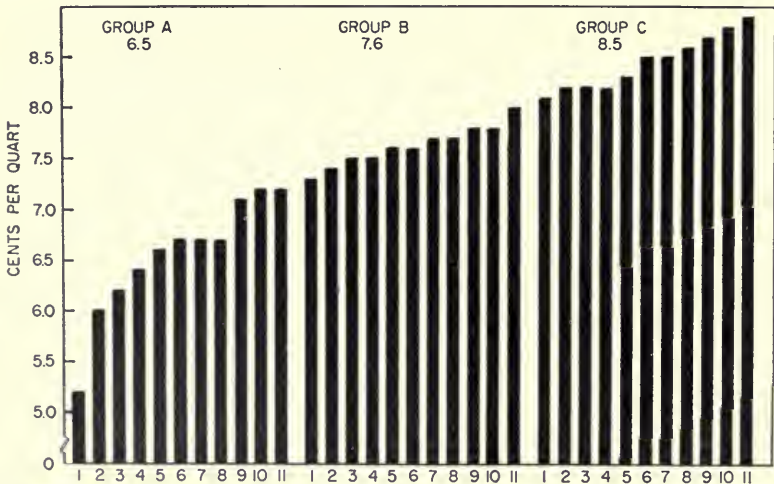
**Portland, Oregon.** Unlike the situations in Boston, Providence, Jacksonville, and Miami, repeal of retail milk price control in Oregon did not bring about lower distribution margins and retail milk prices in Portland. In fact, since decontrol, DGM's and retail milk prices in this market have increased substantially (Fig. 6).

The situation relating to changes in DGM in the Portland market demonstrates that decontrol of any market, in itself, is no guarantee that more efficient distribution methods will be introduced. High margins and high retail prices also exist in some of the uncontrolled markets that have had little or no experience with state control.

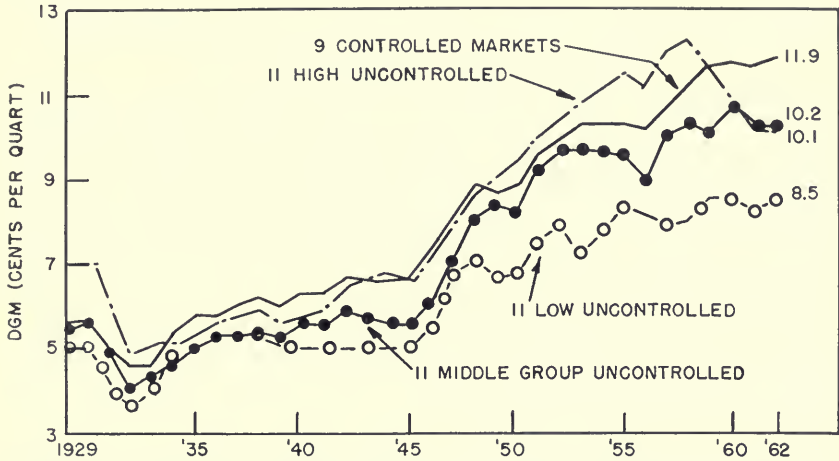
### Uncontrolled Markets Classified Into Three Groups

The 29-year average DGM's (1934-1962) calculated for each of the 33 uncontrolled markets were arranged from lowest to highest and divided into three groups of 11 markets each (Fig. 8). Group A markets had a 29-year average of 6.6 cents; Group B markets, 7.6 cents; and Group C markets 8.5 cents a quart. These averages compared with 8.5 cents for the 9 continuously controlled markets.

Comparison of the year-to-year changes in the DGM's of the three groups with those of the 9 controlled markets (Fig. 9) re-emphasizes the fact that freedom from state retail price control in itself is no guarantee that a market will adopt innovations and new techniques to bring about economical milk distribution. In fact, from 1948 to 1959 the average DGM of Group C uncontrolled markets was higher than that of the 9 controlled markets. As compared with Group A markets, which have efficient milk distribution, Group C markets have been characterized by a "live and let live" policy which has resulted in a relatively high DGM. Under this policy the two or three principal



DGM's for milk sold through stores in 33 uncontrolled markets, 1934-1962, arrayed from lowest to highest groups. (Fig. 8)



DGM's for milk sold through stores in 9 controlled markets compared with 33 uncontrolled markets, grouped by size of margin. (Fig. 9)

distributors in the market, a distributor trade association, or a trade union have effectively curbed or delayed introduction of the efficient distribution methods characteristic of Group A markets. Presumably, Portland, Oregon, is now in a situation similar to that of the higher-margin uncontrolled markets.

Although uncontrolled or decontrolled markets may be slow in adopting new techniques, an innovator of low-cost distribution would come up against only the market power of the conventional distributors or trade unions, not against legalized retail price control. The sharp reduction in distribution margins since 1959 in Group C markets as compared with an upward trend in margins of controlled markets illustrates this difference. Price competition was the key to lower DGM's in the Group C markets. Under control, these sharp reductions in distribution margins would have been impossible.

## Retail Price Control Tends to Curb Milk Consumption

Nutritionists have set up definite standards for the amount of milk that should be consumed by children of different ages and by adults. The recommended minimum daily requirements are 1.75 pints for children up to 12 years old, 2 pints for those 13 to 19 years old, and 1 pint for adults. The per capita requirement, weighted according to age groups, is 1.32 pints a day, or an amount somewhat above the actual milk consumption. Actual per capita consumption is 1.15 pints



daily, of which 0.69 is taken as fluid milk and 0.46 as milk equivalent of other dairy products.<sup>1</sup>

Some people believe that it is impossible to establish the quantities of milk necessary for an adequate diet as precisely as those indicated above. The consensus of nutritionists, however, is that many families, particularly those in the low-income groups, do not consume optimum amounts of milk. Hence regulations enacted by government, including state retail price control, should be directed toward increasing milk consumption.

In analyzing state retail price regulation, two facts should be kept in mind. First, retail milk prices and distributors' gross margins under state control have been maintained at levels above what they would have been under competition; and second, recent studies have shown that the demand for milk, when the price is above 20 cents a quart, is elastic; that is, for each 1 percent change in price, per capita consumption changes more than 1 percent in the opposite direction. A recent study of the writer showed a price elasticity of  $-1.109$  for 36 markets with a retail price above 20 cents a quart.<sup>2</sup>

It is clear that to the extent that state regulation has kept distributors gross margins and retail milk prices at unnecessarily high levels, the per capita consumption of milk has been curbed.

How much has state retail price regulation curbed milk consumption? The answer to this question would depend on the extent to which retail milk prices had been raised above their competitive level. Decontrol of five markets was followed by a sharp decrease in distribution margin and retail prices (Fig. 5). In 1962, the nine markets under continuous retail price control had an average DGM of 3.1 cents a quart above that for the five decontrolled markets. Assuming retail price reductions of 3, 5, and 7 cents a quart, recent studies indicate the potential increase in per capita milk sales in high-price markets would be:

<i>Price reduction per quart</i>	<i>Potential increase in milk sales<sup>3</sup></i>
3 cents.....	13.2 percent
5 cents.....	22.2 percent
7 cents .....	31.0 percent

<sup>1</sup> Calculated from estimates in *Dairy Situation*, Nov. 1963, pages 17 and 19.

<sup>2</sup> Unpublished data. For a review of published elasticity studies, see: R. W. Bartlett, "Potential expansion of sales of fluid milk as related to demand elasticities," Univ. Ill. Agr. Econ. Bul. 7, pp. 24-39, Sept. 1963.

<sup>3</sup> The average retail store price of 37 controlled markets in 1962 was 25.1



## High Retail Price as Related to Milk Consumption in Philadelphia and Pittsburgh

From 1960 to 1963, milk consumption averaged 250 pounds annually per person in Philadelphia and 252 pounds in Pittsburgh.<sup>1</sup> This was 20 percent less than the average per capita consumption in nine other markets in the Northeast (312 pounds) during this same period.

All markets in Pennsylvania, including Philadelphia and Pittsburgh, have been under state retail price control continuously since 1934. Since 1940 retail milk prices in Pennsylvania markets have been consistently above those in markets of the neighboring state of Ohio. A study in 1959<sup>2</sup> showed the average retail price of seven Pennsylvania markets was 25.0 cents or 6.8 cents a quart above that of seven Ohio markets (18.2 cents).

A more recent study showed the average retail price of seven Pennsylvania markets in 1963 was 24.5 cents or 6.6 cents a quart above that for the seven Ohio markets (17.9 cents).<sup>3</sup> Except for a short period in the early 1930s, Ohio markets have not been under state retail price control.

It is, of course, impossible to determine the degree to which lower milk consumption in the Philadelphia and Pittsburgh markets has been associated with high retail prices. On the basis of price elasticity studies, however, it is reasonable to believe that, if competitive conditions such as those which have prevailed in Ohio had been permitted in Pennsylvania, per capita milk consumption in both Philadelphia and Pittsburgh would now be substantially higher, and more nearly in line with nutritional needs of the people in those markets.

## High Prices Encourage Use of Whole Milk Substitutes

The consumption of whole fluid milk in the United States declined from 295 pounds per person in 1956 to an estimated 270 pounds in 1962, a net reduction of 25 pounds or 8 percent.<sup>4</sup> While part of this

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cents a quart. One divided by 25 equals 4 percent, or the proportionate change for each cent that the price per quart of milk was changed. With a price elasticity of  $-1.109$  this would mean a potential increase of 4.436 percent ( $4 \times 1.109$ ) for each cent per quart that the milk price was reduced. The potential increase in milk sales for the different price reductions was computed by multiplying these by 4.436.

<sup>1</sup> USDA Fluid Milk and Cream Reports, May 1962, and May 1964.

<sup>2</sup> From "Trade Barriers in Milk Distribution," Univ. of Ill. Dept. of Agr. Econ., p. 37, June 1960.

<sup>3</sup> Unpublished data.

<sup>4</sup> These figures tend to overstate the loss in consumption of whole fluid milk. During this period there has been an increase in the sale of skim milk items, (footnote completed on next page)

loss in sales may be attributed to fears associated with cholesterol and fall out, another part may be attributed to the increased use of nonfat solids in place of whole milk. Evidence to this effect has been set forth in a study of 1,481 households in 12 southern markets from October 1955 to January 1956,<sup>1</sup> and a personal survey of 871 urban households in Portland, Salem, Albany, and Corvallis, Oregon, in 1958.<sup>2</sup>

The study of the 12 southern markets showed that the cross-elasticity of nonfat dry milk with fresh milk was high; a 1.0 percent increase in the price of fresh whole milk was associated with a 1.4 percent increase in consumption of fluid milk substitutes. Both studies indicated that about half of the nonfat solids was reconstituted for drinking purposes. The Oregon study showed that about two-thirds of the nonfat dry milk was used to replace fresh whole milk.

Of what significance are these studies to state control of consumer prices and to the decline in per capita milk consumption since 1956? Since DGM's and retail milk prices of controlled markets have been higher than those of uncontrolled markets, and since DGM's and retail prices in controlled markets have been increasing faster in recent years than in uncontrolled markets, it may be assumed that unnecessarily high prices of fresh whole milk in state-controlled markets have been responsible, in part at least, for increased use of the less-expensive fluid milk substitutes.

## High Distribution Margins Encourage Law-Breaking

State control of retail prices has created a situation in which efficient distributors are prevented from offering the consumer the benefit of their savings. Under such conditions, some distributors have sought to increase sales by offering wholesalers services and discounts that are considered illegal. The total number of individuals' locations, and opportunities available for breaking the law is so great that adequate policing is nearly impossible. As a result there is only token enforcement of wholesale pricing in most of the states having state control.

In an attempt to make retail price control effective, most authorizing statutes prohibit, as unfair and unlawful:

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including fluid skim milk, low-fat (2%) milk, and flavored skim milk drinks. Annual per capita sales of these products increased from 19.8 pounds in 1956 to 26 pounds in 1962, a net increase of 31 percent. If one ignores the fat content, this increase in sales of skim milk would account for about one-fourth of the loss in fluid milk sales during this period.

<sup>1</sup>Consumption and Demand for Fluid Milk and Fluid Milk Substitutes in Urban South, So. Coop. Ser. Bul. 53, p. 7, Oct. 1957.

<sup>2</sup>Retail sales of Nonfat Dry Milk, Ore. Agr. Exp. Sta. Tech. Bul. 48, pp. 3 and 10, Aug. 1959.

The giving of any milk, cream, dairy products, services, money, or articles of any kind . . . for the purpose of securing or retaining the milk, cream or dairy products business of any wholesale customer or consumer . . . of special prices.

The extension to any wholesale customer or consumer of special prices or services not made available to all wholesale customers or consumers who purchase milk, cream or dairy products of like quantity under like terms and conditions . . . payment of money, credit, compensation, gift or loan of anything of value . . . to a wholesale customer for advertising or display in connection with the sale of a distributor's milk or cream or dairy products, or for the privilege of placing a sign, advertisement, or other advertising material in, on or adjoining any premises occupied by such wholesale customer.<sup>1</sup>

Two major requirements for enforcing state control of consumer prices are (1) an adequate staff of accountants capable of determining minimum prices to be charged consumers and (2) an adequate legal staff for enforcing the law.

In practice, control of prices for those handling milk and milk products has broken down in most states both because of improper pricing and because of lack of adequate personnel to enforce the law. Most markets have as many as 50 or more items on which wholesale and retail prices are established. With the limited number of personnel available, it has been virtually impossible to determine what the distribution margins should be on each of the items at a particular time or what changes in margins were needed from time to time.<sup>2</sup> Consequently, in many markets the minimum prices that were established, which included the DGM plus Class I price, have been fictitious and could not be defended on a cost basis.<sup>3</sup>

In discussing state retail and wholesale pricing, unconfirmed reports and allegations about violations were freely offered by many in the industry. These accounts usually assumed a pattern beginning with "Don't use my name, but let me tell you. . . ."

The allegations usually referred to unearned discounts, rebates, tie-in sales, loans, gifts, and provision of extra services or equipment, such as refrigerators, signs, and display counters. In one instance, a dairy was said to operate a loan service for selected customers, making available substantial sums at no interest and without security pledge or terminal date.

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<sup>1</sup> These provisions are from the Agricultural Code of California. With variations, similar restrictions seeking to accomplish the same purpose have been set forth in other states controlling retail prices of milk.

<sup>2</sup> California is one exception to this. See discussion of this, page 13.

<sup>3</sup> In 1943 and 1944, the author reviewed the cost studies reported in previous hearings of each of the state control agencies then in operation. Results of this study were included in his book *The Milk Industry* (Ronald Press: New York, 1945).

Enforcement officers, of course, are able to track down a certain number of violators, obtain witnesses, and win court convictions. The disposition of such cases is a matter of public record. Perhaps the most unfortunate aspect of this situation, however, is that dealers and distributors who are otherwise law-abiding in all respects have felt forced to use illegal tactics in order to sell milk.<sup>1</sup>

### **Retail Pricing Not Needed to Protect Producer Prices**

When state control was originated in the early 1930s, one of the arguments in its favor was that resale price control was necessary to protect producer prices. This argument was valid in many markets prior to state or federal regulation of producer prices. For example, during this earlier period, if a price war broke out in a city market and the retail prices were sharply reduced, the usual procedure was for producers to share the price reduction with distributors by taking a lower Class I price. But this arrangement no longer exists, and fixed retail prices are no longer needed as a shield for producer prices.

Since 1934, federal milk orders, which establish minimum prices to producers, have gradually been put into operation throughout the United States. These orders may operate in states that also have retail price fixing, but they are entirely independent of this regulation. For example, Boston, Miami, and Providence were all under federal order when their respective states discontinued consumer pricing. Hence in these markets decontrol had no direct effect upon producer prices. Retail price reductions that followed decontrol were absorbed entirely by the distributors.

Furthermore, a state may continue control of producer prices after decontrol of consumer prices. Thus producer prices in Jacksonville and other markets in central and northern Florida were continued under state control after decontrol of consumer prices in these markets.

### **States Cannot Control Producer Prices for Out-of-State Milk**

While courts have substantiated the authority of a state to establish minimum retail prices within the state, the state has no authority to establish prices paid producers for out-of-state milk. In this situation, distributors may be able to buy milk cheaper out of state than from in-state producers at controlled prices. This may give those who do this

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<sup>1</sup>For an excellent report see *Barriers to Increased Consumption of Fluid Milk: A Special Report by the National Grange*, Washington, D.C., Jan. 1955. For an up-to-date review of this situation in one state, Florida, see Appendix B.



still wider margins if they sell milk at state-controlled retail prices. And if some distributors do this and others do not, an inequity results.

This situation is illustrated in Pittsburgh where, as shown, retail prices are regulated. But not shown is the fact that some Pittsburgh distributors buy Ohio milk at a Class I price below the Pittsburgh Class I price. Distributors' gross margins for such distributors buying Ohio milk are wider than those shown (Fig. 4).

### **Retail Price Control Prevents Use of Loss Leaders**

For the most part, mass processing and distributing result in lower unit costs that, under competition, may be passed on to consumers in the form of lower prices. If a milk distributor goes out of business because he is not able to meet this new low-cost competition, he is merely paying a penalty that comes from operating under a competitive system. Any legislation, including state regulation of consumer prices, that is enacted or enforced to keep the inefficient distributor in business is against the public interest. In a period when there are forced adjustments in most industries, it is not reasonable for those in the fluid milk industry to expect to be insulated against change.

On the other hand, efficient milk distributors have a legitimate complaint when milk is sold below cost, particularly when the intent is to force them out of business and later raise prices. The continued use of loss leaders not only is against the interests of the efficient distributors but also is definitely against the public interest.

In the early 1930s, many markets were in a chaotic state. To maintain sales in spite of low consumer income, many distributors were selling milk at a loss. One reason for initiating state control of consumer prices was to prevent this practice. And while state control over the past three decades has not, for the most part, been successful in the wholesale pricing of milk, state regulation of retail prices has been enforced in many markets. Hence if state regulation of retail milk prices were discontinued, some provision should be made to prevent the use of milk as a loss leader. Some means of accomplishing this purpose are (1) enactment and enforcement of legislation prohibiting sales below cost, such as fair trade procedures or markup laws (legislation in some states that control consumer prices already includes these provisions) and (2) more widespread use of existing regulations under the Federal Trade Commission or Department of Justice.<sup>1</sup>

<sup>1</sup> For discussion of pros and cons of these methods see R. W. Bartlett, "Can the use of loss leaders in the store distribution of milk be controlled?" Univ. Ill. Agr. Econ. Bul. 3, pp. 49-69, June 1961.



## Conclusions

One of the biggest problems of mankind is to use the wisdom and knowledge of the ages for the public good without curbing the initiative and creative efforts of each succeeding generation. In our economic organization, the main problem is largely one of balancing competition, which permits freedom of opportunity and individual initiative, with such regulation from the state as has proved desirable.

In our modern economic society, governmental regulation of some kind is inevitable. Such regulation includes laws dealing with public safety, protection of health, education, conservation of resources, banking, and economic security. Such laws have been accepted as necessary by most people.

On the other hand, while every law purports to be "in the public interest," not infrequently laws have been proposed or enacted to protect some vested interest that is not in the public interest. A logical question in connection with this study is: Has state control of retail milk prices been in the public interest?

By keeping distribution margins and retail milk prices unnecessarily high and by discouraging the introduction of new low-cost methods, state regulation of consumer milk prices has curbed milk consumption. Since the present milk consumption rate is less than nutritionists recommend as necessary for an adequate diet, it is evident that in this respect, state retail price control has been definitely undesirable and against the public interest.

Other evidence indicates that by permitting unnecessarily wide distribution margins, state retail price control has encouraged law-breaking in the wholesale pricing of milk through use of secret rebates or refunds and unearned discounts. A law that is not enforced is worse than no law at all. In this respect state retail price control is also clearly undesirable and against the public interest.

Decontrol in Florida, Massachusetts, Oregon, and Rhode Island, all of which had been under retail price control over a long period, was effected without changing the pattern of establishing producer prices. Hence, insofar as producer pricing is related to the public interest, state retail price control is no longer necessary.

In contrast, state retail price control has, in large part, prevented the use of milk as loss leaders. Since the use of loss leaders in milk distribution is definitely undesirable, state retail price control has been in this respect in the public interest.

In view of these facts, one may raise the question: What should be done about state regulation of retail milk prices? The records of three decades of operation indicate that the disadvantages of state retail price control far outweigh its advantages. Hence the logical conclusion, from a public viewpoint, is that *in the 14 states where these controls are still in force, consideration should be given to the elimination of this type of regulation.*<sup>1</sup>

To retain the one desirable element of state retail price control — prevention of the use of milk as a loss leader — some alternative regulation should be set up before decontrol. As stated, this might include use of a fair trade practice regulation, markup law, or other state regulation.

Distributors who have operated under the protection of retail price fixing over a long period frequently protest that decontrol will force most of them out of business. Before Rhode Island was decontrolled in 1961, one state control official said that decontrol would force 100 of the 120 distributors in that marketing area out of business. But in 1964, this area still had over two-thirds as many distributors as in 1961.

It is true that some distributors cannot survive under retail price competition. But when controls are removed, the majority tighten their belts and are able to continue in business by serving consumers in a more efficient manner.

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<sup>1</sup>The principal results of this study were presented by the author at the University of Illinois Agricultural Industries Forum in January 1964. In April 1964, an entirely independent report based upon a three-year study of a committee on milk marketing appointed by Governor Nelson A. Rockefeller of New York was released. The conclusions and recommendations of the Rockefeller report as set forth for New York closely paralleled those which the author has set forth for all states.

Committee members who prepared the Rockefeller report were: From the New York State College of Agriculture, Cornell University — Richard D. Aplin, Associate Professor of Marketing; L. C. Cunningham, Professor of Farm Management; Glenn W. Hedlund (Chairman), Professor and Head of the Department of Agricultural Economics; Leland Spencer, Professor of Marketing; and Robert P. Story, Professor of Marketing. From the School of Commerce, New York University — Jules Backman, Research Professor of Economics. From the State College of Education at Potsdam — Frederick W. Crumb, President. From the Graduate School of Business, Columbia University — R. Parker Eastwood, Professor of Business Statistics.

## APPENDIX A

### METHOD FOR CALCULATION OF DISTRIBUTORS' GROSS MARGIN

In this study the Class I price, adjusted in value to the fat test of milk sold, was subtracted from the lowest reported store price to get the distributors' gross handling margin (DGM). This margin includes the costs of receiving, processing, bottling, storing, selling, and delivering, as well as the profit. Store distribution costs and store profit are also included.

The method used to obtain the distributors' gross margin is illustrated for the Providence market. According to the USDA *Fluid Milk and Cream Report*<sup>1</sup> for May 1962, the following facts were reported for Providence:

1. Class I price for 3.5 percent milk. . . . . \$5.36 per cwt.
2. Prevailing fat test of milk sold to consumers. . . . . 3.7 percent
3. Fat differential for each 0.1 percent fat. . . . . 7.5 cents
4. Lowest reported store price. . . . . 71 cents per gallon

From these facts the distributors' gross margin for May 1962 was computed as follows:

5. Since the fat test was 0.2 percentage point above a 3.5 percent milk, it was necessary to add 15 cents ( $2 \times 7.5$  cents) to the Class I price.  $\$5.36 + .15 = \$5.51$ .

6.  $\$5.51 \div 46.5$  (quarts per cwt.) = 11.8 cents a quart, or cost of raw product.

7. 71 cents  $\div 4 = 17.8$  cents, or price per quart paid by the consumer.

8. 17.8 cents — 11.8 (Class I price) = 6.0 cents, or the distributors' gross handling margin in Providence for store milk sold in gallons in May 1962.

This method was used for each market for each month of the period covered. The annual distributors' gross margin was obtained by dividing the sum of the 12 monthly margins by 12.

<sup>1</sup>For some markets during certain periods, data from these reports were supplemented by data from the market administrator or a trade association.

### APPENDIX B

The following excerpts from a statement by Howard D. Walton are taken from the official record of a public hearing held by the Florida Milk Commission in Jacksonville, Florida, on March 19, 1963. Mr. Walton was a consumer member of the Commission from 1956 to July 15, 1958, and then administrator of the Commission until July 1961. In the statement given here, he spoke as a consumer.

Minor editorial changes have been made in the interest of brevity and clarity. Deleted portions were primarily concerned with producer pricing.

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The WITNESS. I think the real issue at this hearing, in addition to the earlier comments made by you, Mr. Chairman [Charles O. Andrews, Jr.], is also contained in a letter sent to producers [by the president of a large dairy firm, who] advocates in part throughout the letter that there be full controls or no controls at all. This system leaves to the milk distributor the opportunity to revert to the system of making enormous amounts of money that existed prior to this agency tightening up its regulations, pricing producer milk across the board and auditing distributor records, starting back around 1957. [Retail price fixing was suspended in 1957.] . . .

\* \* \* \* \*

Now, you yourself, Mr. Chairman, stated here in your opening remarks pertinent to this hearing that the previous administration, the previous Commission, left the industry in a sad state of affairs and compromised itself on a number of issues. As having been associated with that previous Commission, I would like to say that there was an attempt, a conscientious attempt, to protect the independent distributors of Florida against below-cost selling, at their request. But after the order was adopted, after a great deal of effort was spent to design a means by which the independent merchants in Florida distributing milk could reasonably compete with the national distributors, there was an absolute failure, in my opinion, to enforce it. And that, in my opinion, Mr. Chairman, was brought about solely and simply to create the illusion that the order would not be effective, that it could not work and that the only answer was a return to a system whereby specific prices were fixed in the absence of detailed documented analysis of distributor records, such as the telegram I saw that Mrs. Tomlinson [member of the Commission] sent regarding having the distributor members of the industry file at this hearing or the subsequent hearing copies of their income tax reports. It has never been done. It will never be done. There will never be a full disclosure but simply a continuation of the political effort and pressures to bring about fixed price controls and pressures such as this to bring the producers in line, in my opinion, to support such a move. Thank you.

\* \* \* \* \*

By Mr. CARTER: [Member of the Commission.]

Q. Mr. Walton, did you serve as a consumer member of this Commission at one time?

A. Yes, I did, from 1956 until 1958.

Q. Thinking in terms of the consuming public, would the consuming public be better off in Florida if the producers had Federal controls or the controls of the State Milk Commission?

A. Well, there's a lot of meat to that question. The consuming public would be better off, in my personal opinion, under Federal marketing controls, with qualifications to this extent: that this agency cannot in justice do a better job for the consuming public so long as it continues to have a continuing emergency legislative authority to set fixed retail price controls and so long as these constant efforts day by day, week by week, month by month, are engaged in to bring about a return to the fixed price control system and all of the evils of rebates and under-the-table dealing that were prevalent from the inception of the agency until 1957.

Q. Would you feel it appropriate that this Commission recommend to the next session of the Legislature, first, that the Commission's authority to set retail prices be abolished?

A. Yes.

Q. Would you think it appropriate that we recommend to the Legislature that the Legislature set a time after which this Commission would be abolished?

A. If the Legislature in its wisdom did not see fit to repeal the retail price language of the statute, then I feel that they should set a time prior to the next regular session at which the Commission would go out of existence; because, otherwise, I think this thing will continue and continue and continue.

Q. Now, Mr. Walton, for a period of time you served as administrator of the Milk Commission?

A. That's correct.

Q. Do you feel that it's possible for a state agency such as this to administer a resale price program—first, let me go back. Can a commission such as this adequately administer and audit producer payrolls and ascertain and insure that the milk producers are treated fairly by their distributors?

A. It can do so at the producer level, provided that each person connected with the auditing procedure be of high caliber and competent background and unaffected by political pressures or appointments.

\* \* \* \* \*

[By Mr. CARTER: (Continuing.)]

Q. Would it be fair to conclude your recommendations on this one issue to be that unless the next session of the Legislature would be willing to delete from the statute those provisions which authorize this Commission to establish retail price controls, that you feel that it would be better for them to set a time in the distance when this Commission should be abolished?

A. Yes. And I think that. . . the dairy farmers ought to take a look at what has happened in South Florida, in this area that you are referring to as the Federal Marketing Order down there. There's an example of a group of producers that saw a long time ago what was happening to effective state controls. They took the bull by the horns and through some



great hardships formed an association and brought in the Federal Marketing Order. It's commendable and heart warming to go down into that area and see the businesslike approach that they use in dispatching their own marketing problems.

As you move up the state, Mr. Carter, and the dairies get smaller and smaller and more dependent, out through the Panhandle, on diversified crops, you find less and less interest in looking ahead to the day when these problems have got to be faced. I think that producers in this area, I think that the producers in Central Florida and . . . in the Tampa Bay Area are bringing out some real fine leaders who are seeking the answer to staying in business in Florida, but the days are numbered under the present system.

Q. Mr. Walton, are there any retail price controls under the Federal Marketing Order on the lower East Coast?

A. No. There are no retail controls there, and the Federal controls regulate about 50 percent of the milk supply in this country and there are none in any other part of the United States and none needed.

Q. Good. Now, from your number of years of experience with the milk industry in several capacities, would you feel that politics becomes somehow involved in the milk problem as it is handled by this state agency, this Milk Commission?

A. Well, certainly we're all aware of that. Politics are in every gubernatorial race, and it's only natural that contributors to the successful candidate are going to have a tendency to influence the affairs of state government, particularly in this issue. There's just too much money involved.

Q. When Florida had rigid retail price controls, what was the price of milk per half gallon in Florida?

A. They didn't have half gallons at that time, Mr. Carter. If you remember, about 70 percent of the milk was sold on home delivery routes and the other 30 went to stores, and it was all in one-quart containers. The price was 27 cents a quart in 1956, first part of '57. Then they used to tie two of them together with a little string and give you a penny off, and I believe the price to the store was 25 cents. Then the law said that the price to the consumer, if the consumer bought it out of the store or off the home delivery truck, was equally 27 cents, and . . . only after the controls were repealed in 1957 did we get into the half-gallon containers and the gallon containers.

As a result, as you know, since late 1957 there's been a complete change in the picture. Seventy percent of Florida's milk, approximately, is sold through stores or vending machines or drive-ins of one nature and another, and only about 30 percent remains to be sold by home delivery routes. This is something that just could not — you can't stop these consumer purchasing habits. The housewife wanted to drive to the store, wanted the benefit . . . of the savings there is by picking the milk up at the store compared to the price delivered to the home. There's about a six- or seven-cent per quart cost for home delivery, and the housewife is entitled to that differential if she wants to pick it up elsewhere.

Q. Mr. Walton, you are familiar with an order of this Commission which is commonly referred to as the Fair Trade Order. What do you recall the purpose of that order to be?

A. The purpose of the order, to boil it down, Mr. Carter, was to stop extreme loss leader sales from the various retail store outlets that would drop the price of milk to say, 15 cents or 29 cents a half-gallon unit and to prohibit, on the other hand, the retail store outlets playing one distributor against another for a larger and larger volume discount. That resulted in 1960, [in] representatives of milk distributing firms [being] called into various retail store offices and influenced, for fear of losing the account, to increase the discount given on their volume purchases. That's a very short summation of the whole thing, but in the same breath I think you have to say that it was an attempt by the Commission, where the discount prices were driving prices below cost, to give the independent distributors here in Florida an even starting point for the sale of their milk.

It was demonstrated in 1960 at a hearing, by audits and other records submitted only by the independent distributors of Florida, that the practices engaged in were driving the prices below cost. At that time I was a part and party to the drafting and advocating of that type of a regulation as an attempt to correct those two problems. I sincerely felt that the independent businessmen in Florida were entitled to that opportunity which required complete enforcement by the agency and complete cooperation within the industry to see that that type of an order worked. It has not worked, one, I think, because the agency has not enforced it; two, because the industry collectively, with perhaps a few exceptions, has not wanted it to work; and I think that many of the independent distributors who came before this agency in 1960 seeking relief, begging for relief because of an extreme situation, have forfeited their right to have that relief today because of their repeated association with others in the industry seeking a return to the old fixed price control system.

Q. Mr. Walton, was there any price provision in that order other than the requirement that a distributor not sell his milk below cost?

A. No, none that I can think of, Mr. Carter. The order simply said that distributors were free to file their prices with the Commission but they could not sell below cost, and in determining cost they had to start from the established producer price of this agency. For example, the producer price was 61 cents a gallon. Distributors could not sell their milk below that 61-cent figure plus their normal operating cost. But everybody was free to file their own prices with the agency and were required to sell at the prices on file, except that if someone in the community or in the area could do a better job, were more efficient and could establish a lower price, not below cost, the others could come down to meet it.

Of course, the order went on for several pages to prohibit at great length every conceivable kind of device that the industry has engaged in over the years to reduce price, and I'm talking about the giveaway of equipment, the servicing of refrigerators, the furnishing of services to retail stores that open up, such as setting up their shelving and policing and cleaning the stores. All the little gimmicks that these people engaged in were prohibited, and it was a real fine document, I thought, at the time.

Q. Mr. Walton, is there anything in that order that tells a distributor what he should charge for his milk other than it not be below cost?

A. The price on file; [he] had to sell at the price on file and could not sell below cost.

Q. Is there anything in that order that prevents a man from reducing his filing and selling at a lower price if he can do so without selling below cost?

A. No.

Q. Now, from the retail standpoint is there anything in that order that tells a retailer what he should charge for the milk?

A. Only that he cannot sell it at a price less than he paid for it. For example, if a distributor buys \$300 worth of whole fluid milk during the course of any month and the prevailing filed price is 53 cents a gallon with a 10 percent discount for this wholesale business, then the purchase price to that retail outfit is about 47.7 cents, and he can't sell to the public at less than 48 cents.

Q. Would it be correct to say then that this Commission hasn't for the past two years or more set a price for the resale price of milk but has in effect set up a procedure by which each distributor could set his own price, and the only thing that this Commission has done is provided a board on which they would list their price so that everyone would know what their prices were, and that they are free to change them at any time so long as they don't sell below cost?

A. Essentially you're correct, Mr. Carter, but even that system requires a constant vigilance against members of the industry re-engaging themselves in all of the side practices that they used in prior years to get these accounts.

Q. Yes.

A. And it was an experiment to see if, short of arbitrary fixed marked-up retail price controls, something could be done to put these independent Florida businessmen on the same basis as these national concerns whose resources support localized price wars.

Q. Now, Mr. Walton, under that system, for the past two years milk has sold to the public at varying prices then, has it?

A. That's correct.

Q. What have the ranges of the prices been, roughly?

A. Well, I would say that somewhere between 45 cents for a half-gallon of milk on up to 55 and 57 cents for the same half-gallon of milk.

\* \* \* \* \*

By Mr. CARTER: [Continuing.]

Q. Earlier the Chair had said that he couldn't let Mr. Carter's statement go unchallenged and I wanted to challenge the challenge. My next question was to ask Mr. Walton: Then, in fact, for the last two years we haven't had retail price controls in the State of Florida, have we?

A. Not in my opinion, no.

\* \* \* \* \*

By CHAIRMAN ANDREWS:

Q. Now, one other question. In the Fair Trade Order doesn't it also contain a provision that a distributor can meet a price, can file a price, to meet a competitor's price even though his price is less than his cost of doing business?

A. Yes, and it was specifically designed so that the public could get the benefit of any efficiencies by any distributor that could do the job a little bit better.

Q. And in effect that makes it so that the most efficient producer or producer-distributor can set the minimum price in any area?

A. Yes, if he so desires. Either one of them can, yes.

Q. Did I understand you to say that this system has failed?

A. With qualifications, it has failed. I think I said two or three times here today that it has failed because the order hasn't been enforced. There was a great deal that could have been done to make that system work from the inception. You see, what you have here, Mr. Chairman, I think, is a system where these prices were filed, where these discounts for the volume business were filed, and then there was what's known in the trade as a floating discount in the area, the rebates underneath that which cause some people to file a new price.

Q. Assuming efficient, effective administration, it still would permit the most efficient distributor-producer or distributor to set the price for a given area?

A. It would, but —

Q. Well, now — and that system has failed? Now, the reasons for it, why —

A. I think the reasons are highly important when you consider any revisions of the order, because you can revise the Fair Trade Order to set the — this wholesale price at 185 percent of the producer price, but unless the order was effectively enforced it would mean nothing because of the floating discount in the area.

Q. And you said you were administrator when that order was drawn?

A. That's right.

Q. Doesn't its preamble say that it should be — that the filed price should be on a basis of the efficient producer — distributor?

A. Distributor.

Q. But the enacting clause says that you can meet a price of a loss, of a man — in other words, you can sell at a cost to meet the price?

A. Of somebody that can do the job better.

Q. Of somebody that can do the job better?

A. Right. That's correct.

Q. Therefore the order doesn't enact what it set out to say you would do [what you would say it set out to do]?

A. Oh, yes. I think the order as it was put on the books and as it was initially enforced resulted in accomplishing exactly what it was intended to do as a result of that 1960 hearing. It was only, Mr. Chairman, when these rebates went back into effect below the filed price, when there was a return to the giveaway equipment and giveaway service and all the other special deals not detected and brought out and exposed by your administrative agency, that the difficulties came into practice. It wasn't any difficulty in the area of someone filing to meet the price of the most efficient in the area. There was no [such] difficulty at that time.

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